

Central Intelligence Agency



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**WESTERN EUROPE: ONGOING COUNTERTERRORIST COOPERATION**

**6 MAY 1987**

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This memorandum was prepared by [redacted] Office of European  
Analysis, Issues and Applications Division, Regional Political Issues Branch.  
Questions and comments are welcome and may be addressed to John Gannon, Chief,  
Issues and Applications Division [redacted]

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Terrorism has been increasingly discussed since the late 1970s in the annual Economic Summit held by Canada, France, Italy, Japan, the United Kingdom, the United States, and West Germany. An experts group on terrorism, which plays a role in Summit planning, generally submits a draft declaration for the leaders to incorporate in their final Summit statement. Past Summits issued such agreements as the 1978 Bonn Declaration on aircraft hijacking, the 1980 Venice Declaration on the protection of diplomats, and last year's Tokyo statement on terrorism. [REDACTED]

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Recurrent terrorist acts, the desire to convince their publics of their determination to take effective action, and highly publicized trials of Middle Eastern terrorists in several European capitals have impelled West European governments to a more resolute posture against terrorism over the past year. The European Community, for example, imposed limited sanctions against Libya and Syria, agreed to share more information among themselves, and examined ways to coordinate more uniform extradition policies and border controls. Meanwhile, the Council of Europe has provided a means of involving non-EC members in the battle against terrorism. The Summit Seven intend to expand the Bonn Declaration on hijacking at the Venice Economic Summit this June to cover all forms of terrorism against civil aviation and may broaden the declaration to include general cooperative principles against terrorism. [REDACTED]

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Despite these encouraging shows of determination in combating terrorism, West Europeans remain divided among themselves about the wisdom of moving too aggressively and following the US lead too closely. Many politicians argue that to do so is to expose their countries to terrorist retaliation, to endanger their political and economic interests in the Third World, and to appear to be fronting for Washington. Disclosures of deliveries of US arms to Iran have strengthened the voices of those who argue for caution. Moreover, recent major counterterrorist successes against indigenous terrorist groups--in Spain and France, for example--coupled with a general decrease in terrorist activity in Europe also has removed some of the urgency that enabled governments to expand their powers to combat terrorism. [REDACTED]

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While West European governments are generally supportive of a more sustained policy of cooperation against terrorism and are cognizant of the public benefits of a high

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counterterrorist profile, further progress is likely to be uneven. European leaders will press ahead with regional and bilateral cooperation but will move cautiously in enacting further antiterrorist legislation that might cause judicial and political controversy and complicate policy coordination in multilateral forums. [REDACTED]

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### Vehicles for European Counterterrorist Cooperation

The European Community. Cooperation among the members of the EC has been managed primarily by the Trevi Group of interior and justice ministers and a European Political Cooperation working group on terrorism established by the EC foreign ministers last year. The Trevi group, currently chaired by Belgium, is continuing a number of initiatives begun during the British presidency. A new working group on immigration is exploring methods of curtailing the flow of asylum seekers and abuse of the right of asylum by terrorists. The Twelve are also exchanging information on terrorist suspects through a secure telecommunications network. [REDACTED]

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A noteworthy development last year was the willingness of EC members occasionally to forgo consensus. The Foreign Ministers condemned Syria last November and the Trevi group agreed on a terrorist threat assessment for Western Europe in December even though Greece refused to sign the formal documents in either case. Greece, citing its aversion to "naming names" on terrorism, probably will continue to set itself apart on this issue. [REDACTED]

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The EC Judicial Cooperation Working Group has made some progress in its efforts to simplify extradition proceedings. The new procedure will involve a simple telefax request sent by one Ministry of Justice to another. Since the proposal is being submitted to each country's judicial specialists to consider questions of sovereignty, however, agreement has been delayed for several months. [REDACTED]

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While the United States has no formal relationship with EC groups, it does receive briefings on proceedings. Attorney General Meese, for example, met with the Trevi troika--the past, current, and next chairman--in Brussels in April 1987. The thoroughness of briefings has varied according to the disposition of the presidency country. The Danes, who chair the group next, may not be as forthcoming as the Belgians have been. The EPC working group also has a formal mechanism for EC third country contacts, but consultations require prior approval by the political committee. Working-level exchanges with countries such as the United States are frowned upon by some members--particularly the French--who view cooperation with the

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US as less important than intra-European cooperation. The United States is often able to obtain informal readouts of meetings, but more extensive official contacts are unlikely. [REDACTED]

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The 21-member Council of Europe\* also stepped up its counterterrorist activities. The COE's resolutions are non-binding, but they have served to exert pressure on European capitals to coordinate their actions against terrorism. A COE ministerial conference on terrorism last November coincided with EC debates on Syrian involvement in terrorism and produced a declaration condemning terrorism and a resolution on abuse of diplomatic privileges. Participants agreed to tighten the implementation of the Vienna Conventions on Diplomatic and Consular Relations, which limit the size of diplomatic missions and stress that the premises of a mission not be used in a manner incompatible with its functions. Although no countries were cited specifically, members agreed they would endeavor to adopt a joint position with regard to states that encourage acts of terrorism. [REDACTED]

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Progress was also achieved in bringing all COE members under the 1977 European Convention on the Suppression of Terrorism, also known as the Strasbourg Convention. This convention states that specific violent crimes such as hijacking, hostage taking, and attacks on internationally protected persons are to be considered extraditable crimes rather than political offenses. The last holdouts--Malta, France, Greece, and Ireland--have now signed the convention and indicated their intention to ratify it. The Irish Dail provided the authority for the government to ratify last December, but ratification may be delayed pending discussion with the British on the controversial no-jury tribunals in Northern Ireland. France has said it will ratify with reservations--as have about half the signatories--thus limiting the positive effects of their adherence. [REDACTED]

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Justice ministry officials who formed a new COE committee on terrorism met for the first time in January--and again in March--but made little headway. The committee is charged with developing proposals for closer counterterrorist cooperation among member states, devising ways to impede the movement of terrorists, cooperating with the EC, and informing non-members about ongoing efforts. At the March

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\*In addition to the twelve EC members--Belgium, Denmark, France, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, the United Kingdom, and West Germany--the Council of Europe includes Austria, Cyprus, Iceland, Liechtenstein, Malta, Norway, Sweden, Switzerland, and Turkey. [REDACTED]

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meeting the group concentrated on using existing committees to further its work--a public international law committee and one on the movement of persons, for example. Full reports are expected at a June committee meeting that will review national legislation on terrorism. In the interim, the Council of Ministers is scheduled to address the question of cooperation with non-Council countries. [REDACTED]

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Non-EC members clearly seek an increased role for the Council, but most EC states are reluctant to expand the COE's antiterrorism role and prefer the Trevi group as the primary vehicle for counterterrorist cooperation. EC members consider the COE too large and unwieldy a forum for effective cooperation. They are particularly hesitant to include in their deliberations countries such as Malta and Cyprus, which have close ties to some radical Arab states. [REDACTED]

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One previously neglected area in which the Council may have some impact is media coverage of terrorism. After a contentious debate at its January session, the COE's Council of Ministers agreed that the Secretary General should contact European media organizations with an eye toward agreement on guidelines for journalists covering terrorist events. [REDACTED]

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Summit Seven Experts' Group. Agreement by the experts' group to expand the Bonn Declaration was finally reached in March after the French reversed a prior decision not to participate. Stiffening the Bonn Declaration, which commits the Seven to suspend air traffic with any country that fails to extradite or prosecute suspected hijackers, will fulfill a commitment made at last year's Tokyo Summit. The expanded declaration will now cover not just hijacking but all forms of terrorism against civil aviation. It will also be extended to include future aviation conventions. [REDACTED]

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Italy and the United States are promoting an even broader declaration at the Summit that would commit the Seven to general cooperative principles such as no concessions to terrorists, a crackdown on abuses of diplomatic privileges and immunities, and renewal of the commitment to extradite or prosecute terrorists. Prospects for agreement will be limited by concern for the safety of West European hostages in Lebanon, the current Italian government crisis, and the fact that Summit members traditionally have been unwilling to limit their freedom of action. [REDACTED]

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Bilateral Efforts. One of the more notable instances of improved bilateral cooperation in Western Europe has been French expulsion of Spanish militants belonging to ETA, the Basque terrorist group. Although France had previously extradited three Basques to Spain in 1984 as a gesture of support for Spanish democracy, the new Chirac government has used an administrative procedure to return over 50

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Basques to Spain over the past year. The French also expelled ETA members to countries other than Spain, including the first person with political refugee status ever expelled from France. [redacted]

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In an attempt to dispel its reputation for "softness" toward terrorists, Italy has actively pursued accords with the US, France, Austria, Greece, Turkey, Egypt, and Morocco that cover international terrorism, organized crime, and drug trafficking. Rome also signed a new extradition treaty with the British in March 1986 that replaced one dating from 1873. In addition, France and West Germany concluded an antiterrorist agreement in April 1987 that provides for the exchange of liaison officers and the expansion of the use of wanted lists. [redacted]

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Domestic Legislation. Upsurges in violence impelled governments in West Germany and France to enact tougher legislation last year.

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In December the Bundestag approved legal measures which classified sabotage on railway lines and plants and firms in the energy supply sector as punishable terrorist offenses. The legislation also gave federal and state police authorities direct access to the central traffic information system to speed up the search for escape vehicles and expanded the competencies of the federal prosecutor to make him responsible for terrorist associations operating from abroad. Although a controversial provision that would have provided immunity for suspected terrorists whose testimony assists in the conviction of other terrorists was dropped, a state's witness provision remains a serious consideration. Total amnesty would not be granted for murder, however. [redacted]

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France has experienced violence from both internal groups and foreign extremists operating on French soil. A national security council to deal with terrorism composed of concerned ministers--Foreign Affairs, Justice, Interior, Public Security, and Defense--was set up in April 1986 and met frequently during the wave of bombings in September. It is unlikely, however, that a permanent organization will be created. Paris' response to the bombings included the requirement that foreigners--except for EC nationals and the Swiss--have visas, random identity and security checks in public places, and deployment of troops along French borders to combat illegal immigration. According to the Public Security minister, after procedures for expelling illegal foreign residents were simplified, more than 1700 foreigners were thrown out of France in a six-week period during September and October 1986. [redacted]

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New laws passed in September extended the period of preventive detention from two to four days and gave the French government the right to dissolve foreign associations "gravely disturbing the peace."

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The government will also be able to reduce prison sentences of convicted terrorists willing to inform on their accomplices, while cash rewards have been offered to those who inform police about suspicious persons. To avoid the thorny problem of giving a legal definition to "terrorism," the law states that certain offenses will be prosecuted as terrorism when they are "linked with an individual or collective enterprise for the purpose of undermining public order through intimidation or terror". Those accused of such offenses are referred to a court made up of seven professional magistrates, until now used only for espionage cases. This type of court recently tried LARF leader Georges Abdallah and unexpectedly sentenced him to life imprisonment. [ ]

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In contrast to the toughening of legislation in France and West Germany, Italy and Spain--where the terrorist threat appeared to be ebbing--are moderating some of their strong antiterrorist laws. Madrid intends to lower the number of days a suspect can be kept in preventive detention, and Rome just approved a new law aimed at reducing the sentences of repentant terrorists who have renounced their former ideology. [ ]

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Outlook. Terrorist acts such as the assassination of General Giorgieri in Italy, the trials of terrorists involved in the Rome and Vienna airport attacks, as well as the hostage situation in Lebanon, will continue to focus attention on terrorism in Western Europe this year and are likely to force West European governments to press ahead in their counterterrorist efforts. [ ]

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Thus, practical cooperation in such areas as the theft and forgery of passports, more effective arrangements for extradition, and a more unified approach to the problems of illegal immigration and abuse of the right of asylum can be expected to continue. The EC, for example, plans to simplify frontier procedures within the Community but will attempt to strengthen controls at external frontiers. Many EC countries are already enforcing stricter travel controls, but are unlikely to go along with France's requirement for entry visas for citizens of non-EC nations. [ ]

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Governments probably will move slowly in introducing further antiterrorist legislation for fear of negative political consequences. Civil libertarians are voicing concern that, in combating terrorists, governments are shifting too much power to the state and the police. Even though West Germany became the first European country to introduce an identity card that can be read by computers and is said to be forgery-proof, its introduction was delayed for four years because of strong opposition by civil liberties groups. The French have expressed similar reservations about a planned computerized identity card and the new non-jury courts. [ ]

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Although police forces and intelligence services have shown more willingness to share information, long-standing problems of competition, rivalry, overlapping responsibilities, and confusion remain. For example, France and Italy still lack a central counterterrorist coordinator with authority over the various services and components that deal with terrorism. Many states also lack the financial and personnel resources to implement far-reaching counterterrorist policies. [REDACTED]

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While there are some prospects for constructive activity at a bilateral and regional level, cooperation in multilateral organizations probably will continue to be limited. Strong collective action has proved elusive for Summit Seven members in the past. For example, the only action ever taken under the Bonn Declaration--against Ariana Afghan airlines--has had little appreciable impact. Any terrorism declaration issued at this year's summit almost certainly will have a high level of generality. [REDACTED]

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Bonn Economic Summit Declaration (July 1978)

The heads of state and government, concerned about terrorism and the taking of hostages, declare that their governments will intensify their joint efforts to combat international terrorism.

To this end, in cases where a country refuses extradition or prosecution of those who have hijacked an aircraft and/or do not return such aircraft, the heads of state and government are jointly resolved that their governments should take immediate action to cease all flights to that country.

At the same time, their governments will initiate action to halt all incoming flights from that country or from any country by the airlines of the country concerned. The heads of state and government urge other governments to join them in this commitment.

The proposed extension of the Bonn Declaration to be issued at the Venice Summit will alter the 1978 declaration to read as follows:

They recall that in their Tokyo statement of International Terrorism they agreed to make the 1978 Bonn Declaration more effective in dealing with all forms of terrorism affecting civil aviation. To this end, in cases where a country refuses extradition or prosecution of those who have committed offenses described in the Montreal Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation\* and/or does not return the aircraft involved, the heads of state and government are jointly resolved that their governments shall take immediate action to cease all flights to that country.

At the same time, their governments will initiate action to halt all incoming flights from that country or from any country by the airlines of the country concerned.

The heads of state and government intend also to extend the Bonn Declaration in due time to cover any future relevant amendment to the above convention or any other aviation conventions relating to the extradition or prosecution of the offenders.

\*The Montreal Convention covers any act of unlawful interference likely to endanger the safety of the aircraft in flight. Article 1 enumerates such offenses:

1. Any person commits an offence if he unlawfully and intentionally:
  - a. performs an act of violence against a person on board an aircraft in flight if that act is likely to endanger the safety of that aircraft; or
  - b. destroys an aircraft in service or causes damage to such an aircraft which renders it incapable of flight or which is likely to endanger its safety in flight; or
  - c. places or causes to be placed on an aircraft in service, by any means whatsoever, a device or substance which is likely to destroy that aircraft or to cause damage to it which renders it incapable of flight, or to cause damage to it which is likely to endanger its safety in flight; or
  - d. destroys or damages air navigation facilities or interferes with their operation, if any such act is likely to endanger the safety of aircraft in flight; or
  - e. communicates information which he knows to be false, thereby endangering the safety of an aircraft in flight.

## Summit Statement on Terrorism, May 5, 1986<sup>2</sup>

1. We, the Heads of State or Government of seven major democracies and the representatives of the European Community, assembled here in Tokyo, strongly reaffirm our condemnation of international terrorism in all its forms, of its accomplices and of those, including governments, who sponsor or support it. We abhor the increase in the level of such terrorism since our last meeting, and in particular its blatant and cynical use as an instrument of government policy. Terrorism has no justification. It spreads only by the use of contemptible means, ignoring the values of human life, freedom and dignity. It must be fought relentlessly and without compromise.

2. Recognizing that the continuing fight against terrorism is a task which the international community as a whole has to undertake, we pledge ourselves to make maximum efforts to fight against that scourge. Terrorism must be fought effectively through determined, tenacious, discreet and patient action combining national measures with international cooperation. Therefore, we urge all like-minded nations to collaborate with us, particularly in such international fora as the United Nations, the International Civil Aviation Organization and the International Maritime Organization, drawing on their expertise

to improve and extend countermeasures against terrorism and those who sponsor or support it.

3. We, the Heads of State or Government, agree to intensify the exchange of information in relevant fora on threats and potential threats emanating from terrorist activities and those who sponsor or support them, and on ways to prevent them.

4. We specify the following as measures open to any government concerned to deny to international terrorists the opportunity and the means to carry out their aims, and to identify and deter those who perpetrate such terrorism. We have decided to apply these measures within the framework of international law and in our own jurisdictions in respect of any state which is clearly involved in sponsoring or supporting international terrorism, and in particular of Libya, until such time as the state concerned abandons its complicity in, or support for, such terrorism. These measures are:

- Refusal to export arms to states which sponsor or support terrorism;
- Strict limits on the size of the diplomatic and consular missions and other official bodies abroad of states which engage in such activities, control of travel of members of such missions and bodies, and, where appropriate, radical reductions in, or even the closure of, such missions and bodies;
- Denial of entry to all persons, including diplomatic personnel, who have been expelled or excluded from one of our states on suspicion of involvement in international terrorism or who have been convicted of such a terrorist offence;
- Improved extradition procedures within due process of domestic law for bringing to trial those who have perpetrated such acts of terrorism;
- Stricter immigration and visa requirements and procedures in respect of nationals of states which sponsor or support terrorism;
- The closest possible bilateral and multilateral cooperation between police and security organizations and other relevant authorities in the fight against terrorism.

Each of us is committed to work in the appropriate international bodies to which we belong to ensure that similar measures are accepted and acted upon by as many other governments as possible.

5. We will maintain close cooperation in furthering the objectives of this statement and in considering further measures. We agree to make the 1978 Bonn Declaration more effective in dealing with all forms of terrorism affecting civil aviation. We are ready to promote bilaterally and multilaterally further actions to be taken in international organizations or fora competent to fight against international terrorism in any of its forms.

Central Intelligence Agency

Washington, D C 20505

VENICE SUMMIT: COUNTRY POSITIONS

6 May 1987

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This typescript was produced by analysts in the Office of European  
Analysis and Office of East Asian Analysis. Questions and comments can be  
directed to [redacted] Chief, Western Europe Division [redacted]

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## OUTLOOK FOR THE VENICE SUMMIT

This year's Summit will be held against a backdrop of worrisome trends in the global economic outlook that call for deliberate and difficult policy steps by the major industrial countries. Most ominous are the large external and budgetary imbalances, which will not be reduced substantially under current policies despite the fall of the dollar. Failure to adjust imbalances has also raised the specter of increasing protectionism. Moreover, relatively moderate economic growth of the last few years has given way to projections of slower gains this year and next, with unemployment in the Big Six at high levels and growing. Combined with continued volatility in the foreign exchange markets and the prospect of increasing interest rates, the worsening economic outlook also bodes ill for Third World debtors and for an orderly resolution of the debt crisis.

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Summit governments appear reluctant to take the necessary adjustment measures, particularly in fiscal policy, to reverse the troublesome outlook. There are few new ideas on the Summit agenda about how to resolve the problems, and the initiative undertaken at Tokyo on macroeconomic policy coordination and indicators offers at most a useful focus for discussions on how to redress imbalances. National economic policy objectives invariably will preclude governments from agreeing on any system that would mandate policy changes. The Summit countries have experimented with target exchange rate zones, but the dollar is still falling and markets remain volatile. Without a true stimulative package from the the Japanese, and to a lesser extent the West Germans, slowly deteriorating economic conditions and volatile currency and financial markets are almost assured. As a tradeoff for stimulative moves by the surplus countries, the US will be pressured to bring the budget deficit under control and to fight protectionism.

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Domestic factors will motivate most of the principals attending the Summit to strive for a non-controversial, cooperative event that will put them in a good light with their respective home audiences. Several of the countries involved will be holding major elections following the Summit. Italy and possibly the UK will be in the midst of election campaigns, and France must hold a presidential election before May 1988. Prime Ministers Nakasone of Japan and Mulroney of Canada have both suffered substantial declines in the polls and also will be trying to shore up their popularity at home. Of the foreign leaders, only Chancellor Kohl will be coming to the Summit relatively undistracted by domestic political constraints.

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Summit economic discussions are likely to be dominated by the problems of large global imbalances and the need for coordinated economic policies, including stimulative packages. Trade liberalization, agricultural reform,

and exchange market developments are also likely to be high on the agenda. In a number of these areas, Japan will face a hostile environment with virtually 'no friends' at Venice. Summit leaders also will be worried about LDC debt. Most Big Six governments are unhappy about the Baker Plan, but we do not expect them to propose major new initiatives. Some leaders have pet ideas about the issue, including various schemes for increased aid--with fewer strings attached--and debt-equity swaps. In the end, we expect Summit leaders will probably have to settle for market-stabilizing statements on exchange rates and for a high-level political endorsement of continuing work in other forums--particularly the OECD's work on structural adjustment and agriculture, and the Uruguay Round of trade negotiations.

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On the political side, discussions will probably center on arms control and disarmament. Venice will be the first venue at which all the leaders of the major free-world countries can collectively discuss the arms control proposals introduced by Washington and Moscow this spring. Other political issues likely to be raised include Gorbachev's domestic reforms and his impact on East-West relations, along with counterterrorism, South Africa, and the Middle East.

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AIDS, which is a topic of major public concern in Europe and Japan, probably offers the best opportunity for a dramatic, cooperative effort against a common enemy. Although a general statement on the subject will be issued at the Summit, there have not yet been any proposals for a well-funded, multilateral cooperative effort against AIDS. The European leaders are particularly concerned about the spread of the disease.

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Other topics of discussion include the environment, energy policies, nuclear power, and drug trafficking. Proposals for international cooperation on technological and biological research are also likely to be presented.

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The priority issues and special circumstances of the other attendees include:

JAPAN: Prime Minister Nakasone will be trying to reverse his falling popularity and find some way to stay in office beyond October. He probably will be touting Japan's new stimulative measures to deflect criticism of its trade surplus and will try to play up Japan's contributions to the Western Alliance. To allay the fears of major exporters and his other business constituents, Nakasone may press for a strong multilateral commitment to achieving greater exchange rate stability. The Japanese may also push for an endorsement of their "Human Frontier Science Program"--which calls for international scientific cooperation in biological research.

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WEST GERMANY: Chancellor Kohl, reelected last January, will be hoping for a harmonious Summit. Nevertheless, he will strongly defend West Germany's

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conservative economic agenda and protective farm policies. [REDACTED]

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In keeping with the increasing importance of the environment as a political issue, the West Germans have proposed strong language endorsing environmental cooperation among countries. The West Germans will also be interested in strong commitments against protectionism and for stabilizing exchange rates. [REDACTED]

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FRANCE: President Mitterrand is keeping open his options to run for re-election and he will be anxious to maintain the image of a statesman who has risen above the domestic political fray. Prime Minister Chirac, who has clearly signalled his desire to run in the presidential election, will be looking to increase his domestic popularity. Both will focus on defending the French position on agricultural trade and subsidies; neither can afford to be seen by the politically active farmers of France as being slack in this effort. The French will be pushing their initiatives on indicators and economic policy coordination, as well as their ideas on exchange rate target zones and measures to achieve greater exchange rate stability. Prime Minister Chirac is also likely to press for increased aid to Third World nations and may present the Guillaume Plan which calls for agricultural exporters to agree to stabilize prices in sales to rich countries and to use the proceeds to help defray the costs of cut-rate food sales to LDCs. [REDACTED]

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UNITED KINGDOM: Prime Minister Thatcher may well be in the midst of a national election campaign at the time of the Summit and will be primarily interested in taking a leadership role on key issues. While she appears to have no priority agenda items, she will be keen to discuss several major economic issues, including macroeconomic policy coordination, trade, and Third World debt. She will also want to maintain a solid allied front on arms control issues. [REDACTED]

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ITALY: Italian political leaders will be preoccupied by the national election scheduled for 14 June. Italy, represented at the Summit by caretaker Prime Minister Fanfani, will be primarily interested in ensuring that Rome's current political crisis does not damage its image as a major international political and economic player. The Italians may present a proposal on Third World debt and have drawn up a statement on illegal drugs. Given their domestic political uncertainties, they are unlikely to push any controversial initiatives on issues such as the Middle East and arms control. [REDACTED]

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CANADA: Apart from enhancing his popularity at home, Prime Minister Mulroney's main objective will be to push for liberalization of agricultural trade, reduction of export subsidies, and removal of barriers impeding other commodity exports. The Canadians are also likely to press for more help for LDCs, strengthened environmental standards, and a tougher stand on South Africa. [REDACTED]

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THE EC: On economic issues, the EC will be represented at the Summit by EC Commission President Jacques Delors, a former French finance minister. Belgium Prime Minister Wilfred Martens, whose country holds the rotating presidency of the Council of Ministers, may speak for the Community on political issues. The EC leaders will probably be most interested in expanding cooperation to stabilize exchange rates and in maintaining pressure on Japan to cut its trade surplus. On the defensive side, they will want to avoid any language in the Summit statement committing the Community to specific action on agriculture. [REDACTED]

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JAPANPolitical Setting

Prime Minister Nakasone will be after a share of the limelight at Venice to help revive his flagging domestic political standing. In the last six months his popularity has plunged from almost 50 percent to under 25 percent in all major polls. His mistake was to propose a 5-percent sales tax that was criticized by many ruling party supporters as well as the opposition. The issue snarled government decisionmaking and tarnished Nakasone's image. [REDACTED]

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Economic Setting

Continued yen appreciation--16 percent since early January--is squeezing export volume and profits on overseas sales and threatening to halt Japanese economic growth later this year. Japanese manufacturers are also continuing to slash capital investments. Bank of Japan officials are worried that the Japanese economy--which grew only 2.5 percent in 1986--could slip into recession. Simulations [REDACTED]

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[REDACTED] of Japan suggest they may be right: at a rate of 140 yen to the dollar, Japan will probably approach zero growth in the last quarter of this year and the first quarter of 1988. As a result, unemployment--which hit a record 3 percent in January--will probably continue to increase in the months ahead. If this outlook remains unchanged into the summer, Tokyo will probably adopt a more expansionary supplemental budget this fall than it has in several years. With the virtual absence of recent price increases, the inflationary risk of more expansionary fiscal policy is minimal. [REDACTED]

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Goals for the Summit

At previous Summits, Nakasone has played up Japan's political role in the Western Alliance, and he is certain to do the same in Venice by endorsing President Reagan's arms control efforts. In keeping with Allied policy of zero INF on a global basis, he is likely to seek a commitment to follow-on discussions that would lead to removal of any Soviet medium range forces left in Asia on an interim basis. To allay the concerns of large exporters, Nakasone probably also will seek a strong multilateral commitment to achieving greater exchange rate stability. [REDACTED]

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Economic IssuesMacroeconomic Policy Coordination and International Monetary Reform

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Concern over the rising yen is increasing pressure on Tokyo for a shift to a more expansionary fiscal policy. [REDACTED]

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[REDACTED] more government spending or lower taxes is the only way to halt the yen's rise. This, together with a poor economic outlook, will probably lead Tokyo to adopt a more expansionary supplemental budget this fall than it has for several years. Any change in policy is likely to be temporary, with a return to fiscal austerity when the economy rebounds. [REDACTED]

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Structural Adjustment Japanese policymakers recognize the importance of structural adjustment to reducing trade imbalances. In this vein, Prime Minister Nakasone's Maekawa Commission laid out a game plan for such adjustment last year. Political sensitivities, however, have left many of the commission's recommendations on the drawing board. Nonetheless, some moves have been made to shorten the workweek and rationalize the coal industry. Nakasone will be willing to endorse further structural adjustment, but will want to avoid endorsing a specific timetable. [REDACTED]

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Agriculture--Reform and Trade In preparation for GATT negotiations on agricultural reform, Nakasone has called for "correction of differences in prices at home and abroad." Recognition by the agricultural establishment that grain price supports must be determined by the productivity of the most efficient farmers rather than the least efficient, as is now the case, has opened the way for Nakasone to commit Japan to long-term reforms. However, such a change will not affect trade in the immediate future; Japan's Agriculture Minister has told US officials that rice imports are out of the question. Instead, Tokyo probably will offer Washington a

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larger beef import quota and gradual elimination of quotas on citrus and other items. [ ]

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Third World Debt Tokyo supports the Baker Plan and is encouraging Japanese banks to lend more money to troubled LDC debtors. To free up funds, the banks last month formed an offshore company to buy existing loans from troubled LDCs at a discount in exchange for shares in the new company. Tokyo made the discount on these transactions fully tax deductible, thereby permitting banks to write off more loans than they otherwise could. According to press reports, the Finance Ministry will also soon permit banks to take additional tax deductions on reserves held against nonperforming loans of selected LDCs. Tokyo would probably be supportive of similar efforts by other countries. [ ]

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New Round and International Trade With bilateral trade tensions high on all sides, Tokyo is on the defensive and is apprehensive that Washington and Brussels might unite to force concessions from Japan. Tokyo will respond by stressing the steps it is taking to expand domestic demand and emphasizing that the volume of exports and imports has begun to adjust in response to yen appreciation. Japan is also promoting the new GATT round to fend off protectionism. Tokyo favors adoption of a broad intellectual property rights code and identification of barriers to services trade, but the Japanese still do not have an agreed negotiating position for investment issues. [ ]

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#### Other Economic Issues

Energy Tokyo continues to pursue energy conservation, diversification, and research and development. The Japanese recently expressed concern about rising US oil imports, reflecting their fear of renewed oil shortages. [ ]

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Nuclear Energy Tokyo endorses international cooperation to improve nuclear safety and provide emergency assistance. Its own ambitious nuclear research and construction programs are proceeding despite Chernobyl. [ ]

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Environment Tokyo generally maintains strict environmental regulations, but faces strong opposition from domestic chemical companies against measures to protect the ozone layer, perhaps because public awareness of the issue is still low. [ ]

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Science and Technology Nakasone is likely to promote the Human Frontiers Program, which could involve spending up to \$6 billion over a decade to develop the biological sciences, as a new cooperative effort of the Summit Seven. To demonstrate its commitment to basic research, Tokyo is willing to bear the initial costs of establishing the program. [ ]

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## Political Issues

East-West Relations The Prime Minister believes strongly in keeping Western initiatives toward Moscow in step. Thus, he probably will seek other leaders' views of Soviet developments, including Gorbachev's domestic reforms. Japanese policymakers are pleased by the General Secretary's stated interest in better ties with Japan, but so far they consider Soviet overtures a change in style, not substance. Other than on foreign policy issues, Japanese officials have said little about Gorbachev's reforms. [ ]

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Arms Control Tokyo is actively engaged in the INF question because of the SS-20 missiles based in the Soviet Far East. The Japanese support complete elimination of long-range INF in Europe along with a reduction of missiles in Soviet Asia to 100 warheads as an interim step to zero INF on a global basis. Similarly, in the wake of the Soviet Union's mid-April proposals to Secretary Shultz in Moscow, the Japanese are prepared to go along with elimination of short-range INF in Europe as a step toward a global, zero-zero solution in this category as well. The Japanese place particular importance on the Allied commitment to seek follow-on discussions that would lead to removal of remaining warheads in the Soviet Far East. In our view, Nakasone may seek explicit acknowledgment of Asian security interests in Venice Summit documents. Tokyo is close to signing a Memorandum of Understanding on Japanese participation in SDI research, thus joining the UK, Italy, and the FRG, but the Japanese still fear that a broader US interpretation of the ABM Treaty could provoke new domestic objections to participation in SDI. [ ]

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Terrorism We believe Tokyo will remain a "follower" on the terrorism issue. The Japanese would balk, in our view, at tougher initiatives that go well beyond the scope of the Bonn Declaration of 1978, particularly after the public and press criticism of Prime Minister Nakasone for joining in the 1986 declaration naming Libya as a sponsor of terrorism. While favoring aviation conventions relating to extradition and prosecution of terrorists, Tokyo is likely to back away from initiatives calling for economic sanctions against countries accused of sponsoring international terrorism. [ ]

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South Africa Tokyo imposed some mild sanctions against South Africa last September following similar moves by other Western nations and would almost certainly go along with a strong Summit declaration against apartheid. Prime Minister Nakasone and other senior Japanese government leaders recently met with African National Congress leader Oliver Tambo, as part of Tokyo's policy of expanding contacts with the black community. In general, however, South Africa is not a high-priority issue for Japan. [ ]

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Middle East The Middle East has not been one of Nakasone's major interests as Prime Minister although he will stop in Turkey, Egypt, and Saudi Arabia on his return from Venice. Japanese interest in securing oil has shaped a government policy that favors Arab interests--including recognition of the Palestine Liberation Organization--since the early 1970s. Tokyo supports an international peace conference on the Arab-Israeli dispute that would be in keeping with UN Security Council resolutions 242 and 338. We believe Tokyo probably would consider Soviet participation in such a conference more or less inevitable, despite US reservations and, in any event, difficult to oppose given the broad framework. [REDACTED]

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Iran-Iraq Intensified fighting in the Persian Gulf War has reawakened Japan's fears about oil supply disruptions. Despite a policy of avowed neutrality, the Japanese have long tilted toward Tehran to protect their larger economic stake in Iran. Ideally, the Japanese would like to see both sides emerge intact from the conflict. Toward this end, Japan's Permanent Representative at the United Nations last month presented the Secretary General with a framework for a ceasefire and an end to the war. The package was not an original initiative, drawing instead on existing UN resolutions that have so far not provided the basis for a solution. Foreign Ministry officials will be travelling to Iran and Iraq early next month to urge both sides to resolve their differences. Japanese companies continue to ship dual-use items to the combatants and evade official efforts to deny critical items such as outboard motors by transshipping them through Europe. [REDACTED]

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WEST GERMANY

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Economic Setting

The West German economy is foundering. Early 1987 data for both industrial production and orders indicate economic contraction. The weakness--now spreading to domestic spending--originates in the foreign sector, which is staggering from the 50 percent appreciation of the mark against the dollar over the last two years. West Germany's real net exports have fallen in each of the last six quarters, and declining foreign demand held last year's growth rate to a slow 2.4 percent despite strong consumer and investment spending. [REDACTED]

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The Kohl government retains its official 1987 forecast of 2.5 percent real growth, but spokesmen publicly concede that 2.0 percent is a more realistic target. Based on simulations of our quarterly econometric model, we believe 1.5 percent real GDP growth is even more likely. Moreover, these are considerable downside risks. Further dollar depreciation would hurt severely. We estimate, for example, that a fall in the dollar to 1.6 marks during the present quarter would trim 1987 growth by a further 0.3 percentage points. Although the recent metalworkers' contract settlement has averted a crippling strike this year, industry has accepted substantial labor cost increases over the next three years, which a strong mark will make difficult to pass through. [REDACTED]

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Fiscal policy, contractionary for most of Kohl's tenure, was eased somewhat last year by tax cuts. Although the government continues to resist earlier implementation of its tax reform proposals, Bonn also agreed, at the Louvre G-5 meeting, to add \$3 billion to a scheduled \$5-billion 1988 tax cut. Despite concern for its credibility in financial markets, the Bundesbank is allowing money supply growth to exceed its target ranges for the second consecutive year. We believe, however, that the coincidence of an appreciating exchange rate and domestic price deflation gives the Bank room for additional credit expansion and interest rate cuts. [REDACTED]

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### Goals for the Summit

As he begins his second term, Kohl hopes that a harmonious Summit will polish his image as a world statesman. He expects no dramatic decisions to emerge from Venice. Notwithstanding his desire for an uneventful meeting, the Chancellor will not shrink from answering US criticisms of West Germany's conservative economic agenda or protective farm policies. Fearful that the world trading system is slipping toward protectionism, Kohl will press for a US commitment against restrictive legislation or unilateral actions. He also wants the Summit to endorse the April G-7 accord on stabilizing exchange rates. Kohl expects informal discussion of Soviet domestic and arms control initiatives, although he apparently has no specific proposals in this regard. [REDACTED]

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### Economic Issues

Macroeconomic Policy Coordination and International Monetary Reform  
West Germany, a reluctant and minimalist participant in past efforts to cut interest rates and spur economic growth, is not inclined to alter its domestic policies for the sake of international cooperation. Arguing that their policies of inflation control, budget consolidation, and free trade are conducive to global stability, the Germans will urge other Summit participants to follow their example. Kohl will reject arguments that West German reflation can appreciably improve the US current account deficit or world economic growth. Moreover, Bonn may point to recent estimates that the German budget deficit is rising to counter arguments that they are running too tight a fiscal policy. Bonn, despite agreeing to strengthen the indicator process, is skeptical of proposals for economic convergence or monetary reform that would commit West Germany to policy changes. West Germany does acknowledge, however, the usefulness of coordinated intervention to stabilize exchange rates [REDACTED]

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Structural Adjustment The Kohl government's record on structural reform is unimpressive. Although the Chancellor endorses free competition and deregulation in principle, his government has been slow to ease regulations and rigidities in such sectors as transportation,

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telecommunications, and retailing, as well as in the labor market. Subsidies for depressed industries, such as coal, shipbuilding, and steel, have actually risen under the conservatives. Bonn probably would back a statement applauding work in the OECD and other forums as contributing to the removal of obstacles to growth, but would stress that the task must be undertaken multilaterally if it is to succeed. [REDACTED]

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Agriculture -- Reform and Trade Heavily influenced by domestic political considerations, Bonn has emerged as the main impediment to West European agricultural reform. Kohl is determined to placate West German farmers who withheld their votes from the Christian Democrats in last January's election to express dissatisfaction with the government's agricultural policies. Bonn is blocking EC reform measures and threatening greater use of national subsidies if Brussels does not do more to maintain farmers' incomes. During the Summit, Bonn--while preferring to let the French play their traditional role as defenders of the CAP--is likely to argue that relying principally on price reductions to reform the agricultural system imposes social costs on the German farmer the government cannot accept. Bonn will argue that overproduction must be curtailed--and would support language to that effect--but believes this should be accomplished by quotas. While willing to discuss agricultural issues in the GATT, it probably believes the method of reform must be resolved before it can support fast action. [REDACTED]

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Third World Debt The West Germans are disturbed by the deteriorating LDC debt situation, but, despite their view that the Baker Plan has been a failure, they have no new solutions to offer. Bonn opposes measures that would only provide debt relief but favors new loans for LDCs that undertake structural reforms. Kohl may urge Summit leaders to ease tax regulations for bad loan write-offs by banks. Bonn favors greater resources for the World Bank and IDA and special concessions for Africa. [REDACTED]

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New Round and International Trade The West Germans are concerned that the other Summit participants--particularly the US--are backing away from free trade. They are annoyed by unilateral US actions, such as the machine tool import decision, and alarmed by the possibility of a US-Japan trade war. Bonn will again endorse the Uruguay round and urge its trading partners to refrain from new restrictions while multilateral negotiations proceed. [REDACTED]

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#### Other Economic Issues

Energy The West German government, taking advantage of low oil prices, has increased the amount of energy stocks it holds, with the goal of reaching a 65-day supply in 1988. Bonn would probably welcome calls to increase the amount of energy stocks held by both the government and private concerns. [REDACTED]

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Nuclear Power Kohl supports the continued operation of West German nuclear plants and will probably be willing to back a statement in the communique supporting increased use of nuclear power. [REDACTED]

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Environment Environmental protection has become a major political issue in West Germany in recent years, and the Kohl government is interested in demonstrating its commitment to environmental improvement. The West Germans have proposed language for the communique that emphasizes increased cooperation on environmental matters. [REDACTED]

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Science and Technology Chancellor Kohl will welcome Nakasone's proposal on technology cooperation, the "Human Frontier Science Program." For budgetary reasons, he would probably second a suggestion that the Japanese fund the program during its early years. [REDACTED]

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### Political Issues

East-West Relations West Germany's relations with the Soviet Union are warming again following a chill that set in after Kohl implicitly compared Gorbachev with Nazi propaganda chief Goebbels last October. The thaw began shortly after the election in January, and since then a number of high-ranking West German political leaders have visited or plan to visit Moscow, including Genscher and President Richard von Weizsaecker. Soviet Foreign Minister Shevardnadze is expected to visit West Germany in September, and hints of a Gorbachev visit next year are emerging. Genscher in particular has pushed for better relations with Moscow and has urged the West to respond positively to Gorbachev's domestic and arms control initiatives. Kohl's assessment has been more guarded, but he has expressed the hope that the Soviet leader's policy of glasnost and domestic reforms could lead to better relations with the West and to major arms control advances. [REDACTED]

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Bonn is concerned about how Gorbachev's domestic reforms and foreign policy initiatives will affect Eastern Europe--particularly East Berlin and East Germany--and Kohl is likely to want to discuss this topic at the Summit. Bonn--with Genscher in the lead, but with widespread support among other political leaders--continues to promote an increase in trade and other exchanges with East Bloc countries as a means both to ease East-West tension and to improve the lot of the East Germans. Kohl may also try to encourage US interest in the West German/EC proposal to convene an East-West trade conference. As envisaged by Bonn, this conference would bring together decision-makers from government, business, and industry to discuss ways to inject dynamism into East-West trade relations. [REDACTED]

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Arms Control and Disarmament Chancellor Kohl has consistently stressed his commitment both to arms reductions and the Western Alliance. He has publicly praised US-Soviet offers to eliminate intermediate-range nuclear missiles from Europe, but he has serious concerns about the elimination of nuclear systems with a shorter range because of the Warsaw

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Pact's advantage in battlefield nuclear and conventional forces. Bonn will press for talks on shorter-range systems to follow closely an agreement on INF. The West Germans, in addition, probably would like to see talks on conventional, and possibly chemical weapons, linked to any SRINF negotiations. [redacted]

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Bonn favors research on strategic defense systems to keep pace with Soviet research in the area, but opposes a broader interpretation of the ABM treaty and has reservations on SDI deployment. West German firms are allowed to participate in SDI research programs under the terms of the 1986 framework agreement between Bonn and Washington in hope of reaping technological and commercial benefits. [redacted]

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Terrorism West Germany generally has taken a tough stand against domestic and foreign terrorism and enacted strengthened counterterrorism legislation just last December. The kidnaping of two West German nationals in Lebanon after the arrest in West Germany of TWA 847 hijacker Mohammad Hammadi, however, has complicated the Kohl government's response to a US request for his extradition and prompted Bonn to look for possible deals to free them. We believe Bonn probably will decide to try Hammadi on yet unspecified charges instead of honoring the US extradition request. Nonetheless, Bonn has generally supported greater international cooperation against terrorism and would back a strong statement condemning terrorism and its sponsors, as well as a strengthening of the 1978 Bonn Declaration against airplane hijacking. [redacted]

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South Africa Three tenets guide Bonn's policy toward South Africa: no new sanctions other than those the EC imposed in 1986, provision of aid and training to South African non-whites, and encouragement of a Western political initiative against apartheid. The government has strongly condemned Pretoria's new restrictions on demonstrations and freedom of expression, and would probably support a strong Summit declaration against apartheid. [redacted]

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Middle East West Germany, while not a major player in the Middle East, has been a supporter of EC political and economic initiatives seeking settlement of conflicts and economic development in the area. Bonn has supported the idea of a UN-sponsored international conference on the Middle East conflict. Bonn currently is debating whether to loosen its restrictive policy on arms sales to the area [redacted]

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Iran-Iraq West Germany fully supports the EC's stance on the Gulf conflict, which calls for an immediate halt to all hostilities and a negotiated peace settlement. Bonn maintains a policy against selling arms to belligerents; although West German arms may have reached both Iran and Iraq, we have no evidence that the government sanctions or even knows of such sales. While the Kohl government publicly maintains strict neutrality toward the belligerents, the recent kidnaping of two West Germans by a

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pro-Iranian Hizballah group may encourage Bonn to pursue a more conciliatory policy toward Tehran. Bonn reacted mildly, for example, to Iranian anger and diplomatic sanctions last February occasioned by a West German television program which Tehran found offensive. Bonn also declined to follow a US request to make a demarche to Tehran after the latter tested Silkworm missiles over the Strait of Hormuz in early March. [REDACTED]

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FRANCEPolitical Setting

The difficult and unprecedented period of powersharing between conservative Prime Minister Chirac and Socialist President Mitterrand is likely to continue until the presidential election scheduled for spring 1988. Mitterrand and Chirac have generally been careful to speak with one voice on substantive issues and apparently coordinate carefully on major foreign and defense policy decisions. Nonetheless, differences appear occasionally over matters of emphasis, timing, and apportioning of credit for successes. Both leaders will be especially careful to act in harmony at the Summit to present the image of a powerful, united France. Mitterrand will continue to assert his primacy in foreign and defense policymaking, while Chirac will try to make it clear that he is in charge of French economic policy. [REDACTED]

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Economic Setting

France faces poorer economic prospects in 1987, and this is likely to weigh heavily on Prime Minister Chirac in the run-up to next year's election. We estimate that French growth this year will be 1.7 percent, down from 2 percent in 1986, largely as a result of slower growth in private consumption. Unemployment, which hit 11 percent in February, will continue to inch up and may top 12 percent by the end of next year. Inflation will pick up somewhat to about 3 percent, in part as a result of removal of price controls, belying earlier government predictions of a further decline. France's politically sensitive trade balance is also likely to worsen, with the current account surplus sliding from last year's \$3.6 billion to about \$3 billion in 1987. [REDACTED]

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Goals for the Summit

The main preoccupation of Mitterrand and Chirac at the Summit will be to enhance their image at home. Both received good marks from the French press and public for their performance at Tokyo last year, and they especially want to avoid unseemly squabbling. Mitterrand will try to project himself as a statesman and leader who has risen above the domestic political fray and is capable of speaking effectively for France. Chirac is looking to the Summit to boost his flagging domestic popularity as he prepares to bid for the presidency next year; in particular, he will want to distance himself from his Socialist predecessors and demonstrate that France can play a constructive and influential role in international economic affairs. From a substantive perspective, Paris is looking for progress in reforming the international monetary system. France will probably also seek a Summit commitment to redouble efforts to defuse the LDC crisis and may suggest new schemes to stabilize export earnings of debtors. The French will probably agree on a general declaration against terrorism, and they will emphasize their security concerns arising from recent arms control proposals. [REDACTED]

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## Economic Issues

Macroeconomic Policy Coordination and International Monetary Reform  
France, in the forefront of Summit countries calling for greater policy coordination, strongly supports the indicators approach. Both Mitterrand and Chirac agree on the utility of indicators, and Finance Minister Balladur is a staunch advocate of enhanced discipline in policy coordination. Nonetheless, Treasury Director Lebegue has stated that Paris wants to avoid using the indicators approach to connote any fine tuning of economic policy, describing the French position as one in which pre-agreed movements of indicators would trigger consultations among the G-5, not policy changes. [REDACTED]

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France is also supportive of efforts to help stabilize exchange rates and welcomes recent G-5 agreements as a vindication of long-standing French views. Paris favors stepped-up efforts at currency management. [REDACTED]

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[REDACTED]

[REDACTED]

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French officials agree on the need for West Germany and Japan to stimulate their economies, and Paris is sharply critical of Bonn's reluctance to take strong measures. Pressure is growing on Chirac to reflate the French economy in advance of the presidential election, although Balladur, fearing it will lead to charges that the government abandoned austerity for partisan reasons, reportedly remains unalterably opposed. Both would welcome action by Bonn and Tokyo to lessen the French dilemma by helping stimulate French exports and growth. [REDACTED]

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Structural Adjustment Structural adjustment is unlikely to be a prominent issue for the French at Venice. In discussions of this issue the French--and Chirac in particular--will point to domestic reforms aimed at modernizing the French economy, such as extensive financial market reforms, denationalizations, and price and exchange decontrol. France remains supportive of OECD work in this area. [REDACTED]

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[REDACTED]

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Agriculture -- Reform and Trade The French remain deeply suspicious of US tactics on agricultural reform. France--now a net EC contributor--has grudgingly come to realize that the Common Agricultural Policy (CAP) is sorely in need of reform, but Paris continues to guard the CAP zealously against outside challenges. French tactics will continue to be a mixture of stalling on procedural grounds and attempts to broaden the issue to include discussion of all forms of trade-distorting support to agriculture in order to deflect criticism aimed at EC agricultural export subsidies. French officials repeatedly stress that, for domestic political reasons, they are unable to negotiate meaningfully on agriculture before next year's presidential election. If given the opportunity, Chirac may float the Guillaume Plan, originated by his Minister of Agriculture, which calls for agricultural exporters to agree to stabilize prices in sales to rich countries--such as Japan and the Soviet Union--and to use the proceeds to help defray the cost of cut-rate food sales to LDCs. [redacted]

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Third World Debt French leaders are increasingly concerned about the explosive potential of Third World debt, fearing that the debt crisis will worsen appreciably during 1987 and 1988 as OECD growth slows. French officials believe that a solution for the LDCs must include both an infusion of fresh money and a partial debt writedown. [redacted]

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[redacted] A close adviser to Chirac has told US diplomats that the Prime Minister is particularly concerned that economic turmoil in the Third World may encourage Soviet meddling. Chirac believes attacking hunger should be a priority in Western development efforts, not the least because he fears that the West is vulnerable to Soviet criticism of its agricultural surpluses. [redacted]

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New Round and International Trade Apart from its misgivings over agriculture, France is committed to--indeed enthusiastic about--the Uruguay Round. French leaders are likely to join in a ringing endorsement of the talks. Paris believes that its interests can be furthered in important sectors, especially trade in services. [redacted]

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#### Other Economic Issues

Nuclear Power Paris would eagerly go along with a Summit effort to endorse nuclear power. France is a world leader in civilian nuclear power and is engaged in an aggressive export drive for its nuclear reactors to help defray their high production costs. [redacted]

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Science and Technology France would probably support Japan's call for an extensive international life sciences and biotechnology research program, especially if Tokyo offers to foot most of the bill. The French fancy themselves world leaders in these areas--witness French advances in AIDS research--and would probably suggest the involvement of Paris "centers of excellence" in the project. [redacted]

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## Political Issues

East-West Relations Paris is skeptical of Soviet leader Gorbachev's recent initiatives to liberalize Soviet society--believing that his moves are designed to lull the West into thinking there will be fundamental changes in Soviet policies--and has adopted a wait-and-see attitude. Tensions between France and the Soviet Union have been heightened recently over revelations of Soviet espionage activities in France and expulsions of diplomats. Chirac's trip to the Soviet Union is now scheduled for 14-17 May but could still be cancelled as a result of the spy affair. [ ]

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Arms Control and Disarmament French leaders remain mistrustful of arms control talks in general. They especially fear that an agreement on INF would effectively "decouple" the United States from Western Europe's defense, magnify the importance of Soviet superiority in conventional and shorter range forces in Europe, and increase pressures to include France's independent nuclear deterrent in arms control talks. The French are unlikely to oppose an INF agreement openly, but they will probably work behind the scenes to encourage a cautious approach aimed at forcing additional concessions from Gorbachev on key issues such as the conventional arms balance. They strongly oppose a denuclearized Europe and for that reason clearly do not want follow-on SRINF negotiations. [ ]

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As the possibility of an INF agreement looms, conventional arms control talks will probably assume greater importance in Paris. France will almost certainly not consent to initial French force reductions and will probably continue to exploit ambiguities in NATO agreements on procedural questions and even circumvent relatively firm understandings to block progress that they perceive to be contrary to their national interests. In addition, the French have placed an obstacle to the opening of formal conventional arms control negotiations by demanding a forum closely linked to the 35-nation CSCE, in which Europe's neutral and non-aligned states participate. [ ]

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SDI is considered both a threat and an opportunity by French officials. On the one hand, they are concerned that emphasis on defensive systems could undermine deterrence--the basis of the French defense policy consensus--and stimulate a new and costly arms race. For that reason, they oppose adopting a broader interpretation of the ABM treaty. At the same time, however, they accept the need for SDI research as a hedge against Soviet efforts. Since 1986, Paris has allowed French companies to compete for contracts involving SDI research so that France can reap commercial and technological benefits resulting from the SDI program. [ ]

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Terrorism The French are probably prepared to go along with a terrorism declaration at the Summit, similar to the Tokyo statement, so long as it does not single out individual countries. Paris has had a string of successes against domestic terrorism, including its arrest of four Direct Action leaders and several Middle Eastern terrorist suspects as

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well as police discoveries of several major caches of arms and explosives. The crackdown on domestic terrorism is not reflected in the international arena, however, where Paris has often tried to strike deals in private with hostage-holders and state-sponsors, such as Iran and Syria, to try to secure the release of French hostages in Lebanon. [REDACTED]

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South Africa France, which is showing a renewed interest in southern African issues, has recently taken steps to reinvigorate relations with the Frontline States and to consult with prominent African leaders in the region. An Elysee spokesman said last year that Mitterrand and Chirac had worked out a unified position on South Africa geared to mark disapproval of apartheid without harming France's national interests. Paris supports the limited voluntary EC sanctions currently in force but in principle does not believe sanctions work and would oppose additional punitive measures. The French would probably support a relatively strong declaration against apartheid. [REDACTED]

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Middle East Paris supports efforts to convene a Middle East peace conference including Security Council members and the PLO, and continues to contribute troops to the UN peacekeeping force in Lebanon. Although French relations with Israel have improved since the days of President Giscard, France continues to provide humanitarian assistance to Palestinian refugee camps in Lebanon, and Mitterrand recently reaffirmed the French desire to maintain dialogue with what he referred to as a "coherent and homogeneous" PLO. French officials apparently used Prime Minister Shamir's April visit to Paris to encourage support for a peace conference--though with little success. Paris probably welcomes Syria's recent move into Beirut as a way to bring some stability to the situation. [REDACTED]

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Iran-Iraq France has pursued a two-track policy of providing military assistance to Iraq, while trying to normalize relations with Iran. Paris has sold over \$5.5 billion of arms to Iraq, although current French support is limited to providing replacement and spare parts for French military equipment and maintaining the Exocet missile inventory. France worries that an Iranian victory could threaten French interests in the Middle East and promote the spread of Islamic fundamentalism, but French leaders are torn by the suspicion that Tehran has influence over the hostage-holders and may be directly involved with the kidnaping of French hostages in Lebanon. Attempts to curry favor with the Iranians and normalize relations, however, have slowed during the last few months, and French officials increasingly question Tehran's ability or willingness to negotiate in good faith. [REDACTED]

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UNITED KINGDOMPolitical Setting

Prime Minister Thatcher has been in office longer than any other Summit leader and is well-placed to win yet another term. She has not yet announced a date for the next election, but it is likely to be held in June or October. Campaigning is already under way, and the most recent polling data suggest that the Tories probably will retain their Parliamentary majority. Thatcher is highlighting her role as a world statesman and sees the Economic Summit as an opportunity to build upon her successful Moscow visit in early April. Domestically, the Prime Minister is citing increased spending on education and health services, tax cuts for low-income families, and aid to the inner cities to try to overcome her image as an "uncaring leader." Thatcher's strongest cards are the Labor Party's internal disarray and what voters thus far see as its implausible defense and economic policies. [REDACTED]

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Economic Setting

The British economy is expected to grow by about 3 percent in 1987, placing Britain along with Italy at the top of the growth scale among the Summit countries. Consumers again will provide the major boost for the economy as they take advantage of continued strong growth in real earnings and a cut in taxes. Private investment also is expected to register a healthy increase because of strong corporate earnings and falling interest rates. At the same time, a sharp rise in imports is likely to cause the current account to deteriorate by almost \$2 billion to a deficit of about \$3.5 billion, and inflation probably will approach 5 percent by yearend. Despite a significant downward trend since July, unemployment--11 percent in March--remains a critical problem. [REDACTED]

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Goals for the Summit

The election will be uppermost in Thatcher's mind, and she does not appear to have any specific substantive goals for the Summit. She believes there are several key economic issues to discuss, including macroeconomic policy coordination, trade, agriculture, and international debt. She will also report on her recent trip to Moscow and be prepared to exchange views on how to deal with the AIDS epidemic. If the Summit coincides with the election campaign, she will be especially interested in playing up the British economy's strong performance in 1987 and her personal role as an influential world leader. [REDACTED]

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Economic Issues

Macroeconomic Policy Coordination and International Monetary Reform  
Chancellor Lawson welcomed the recent reaffirmation of the Paris Accord as a "very satisfactory result," but he believes that more policy coordination

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is necessary to stabilize currency markets and facilitate sustainable world growth. He argues that the G-7 countries must use interest rates to control currency swings because currency market intervention is neither sustainable nor effective. British officials believe Japan has primary responsibility for correcting world trade imbalances; London also sees room for West German adjustment but will be more reticent about pushing Bonn. Thatcher will be reluctant to support the use of economic indicators to mandate policy changes, arguing that they should not be used as anything more than a common basis for measuring economic trends. [ ]

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Structural Adjustment Thatcher is committed to the structural adjustment of the British economy. Her efforts to date include the privatization of many state-owned industries, reform of trade union laws, and deregulation of Britain's financial markets. If reelected, the Tories would continue these reforms and tackle the inefficiencies caused by Britain's generous welfare benefits. Thatcher almost certainly would support a statement at the Summit calling for accelerated structural reforms in OECD member countries and in the LDCs. [ ]

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Agriculture--Reform and Trade London continues to be at odds with France and West Germany in arguing for more realistic agricultural policies in the EC to reduce support prices and production. The British want to incorporate the OECD's work on agriculture into the GATT negotiations but believe it is too early to press for a rapid conclusion to the talks. At the Summit, Thatcher will try to focus the discussions on reform of domestic agricultural policies in the individual Summit countries. She is concerned about the high cost of farm expenditures in Britain, but is reluctant to take bold action to reduce government support because British farmers are an important Tory voting bloc. [ ]

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Third World Debt London supports Secretary Baker's strategy for dealing with the debt crisis, but will push for more flexibility in its implementation. Chancellor Lawson's recently proposed plan to ease the burden of the poorest African debtors calls for converting loans in bilateral aid programs to grants, rescheduling other loans with longer maturities and longer grace periods for capital repayment, and introducing concessional interest rates. [ ]

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New Round and International Trade The British will encourage Summit participants to address what London sees as fundamental problems in international trade and to avoid getting bogged down in issue-by-issue disputes. London is generally pleased with progress so far on the new GATT round, but does not support fast-track talks. London is particularly interested in four themes for the Uruguay Round: agriculture, services, reversing protectionist tendencies, and integrating the NICs fully into the world trading system. The British are generally supportive of US views in these areas. [ ]

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### Other Economic Issues

Energy London remains unconvinced of the need to increase strategic oil stocks. Thatcher will not support US initiatives on this issue, because she fears it would undermine London's negotiations to reduce Britain's stocking obligations to the EC. Nevertheless, the British, who currently are meeting their IEA stocking obligations, will probably try to persuade other members to do the same. [redacted]

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Nuclear Power Thatcher would welcome a statement by the Summit countries supporting the expansion of nuclear power. She would hope to use it to try to moderate domestic opposition to the construction of a nuclear power plant her government has recently approved. [redacted]

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Science and Technology London continues to support British participation in SDI research--particularly projects with potential spillover to the civilian sector. Britain is currently negotiating with its EC partners over a several-billion-dollar budget for funding joint Community projects. Thatcher probably will support Nakasone's "Human Frontier Science Program," but she will also encourage the Japanese to provide funding for the project. [redacted]

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### Political Issues

East-West Relations As the most recent visitor to the Soviet Union, Thatcher almost certainly believes she is the most well-versed of the group on Soviet attitudes toward arms control, regional foreign policy issues, and domestic reform. Thatcher [redacted]

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[redacted] may also support Bonn's idea of an East-West economic summit as a way to test Gorbachev's desire to open the Soviet economy and society to the West. Thatcher welcomes any increase in non-strategic British-Soviet trade that ensues from new Soviet overtures to the West. [redacted]

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Arms Control and Disarmament The British welcome US-Soviet negotiations to reach an INF accord, but they have reservations about Moscow's recent proposal to eliminate short-range nuclear weapons in Europe. London worries that a "denuclearized" Europe would decouple European defenses from the US, weaken NATO's doctrine of flexible response, and make the Allies more vulnerable to Soviet conventional attacks. The British want to reduce SRINF in lieu of a zero/zero agreement while retaining the right for NATO to match Soviet short-range nuclear arsenals, but it would be difficult for Thatcher to reject a zero/zero agreement on the eve of an election. London favors an agreement on conventional weapons and has argued that new negotiations on conventional forces should be tied loosely to the CSCE to encourage French participation. Although Thatcher

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appears to be somewhat more willing to accept a broader interpretation of the ABM Treaty than other West European leaders, she continues to be wary of SDI deployment. She has repeatedly reminded Washington of the 1984 Camp David Agreement on SDI research which stipulates that deployment of the missile defense system has to be preceded by negotiations with Moscow. [ ]

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Terrorism Thatcher almost certainly believes that in view of her cooperation with the US in the raid against Libya, her breaking of UK diplomatic relations with Syria, and the revelations of US arms dealings with Iran, she is now the undisputed leader of the fight against international terrorism. She will support a strong declaration against terrorism and its sponsors and a strengthening of the Bonn Declaration against airplane hijacking. Thatcher will also try to convince other Summit leaders to continue to isolate the Syrians on the diplomatic front until Damascus demonstrates that it no longer supports terrorism. Nevertheless, the British remain dubious about the efficacy of either military retaliation or economic sanctions against nations suspected of sponsoring terrorism. [ ]

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South Africa The British remain strongly opposed to major economic sanctions against South Africa and would not want to go beyond the mild measures the EC enacted in 1986. Thatcher argues that they do not work, but she also faces powerful opposition from members of the Tory Party who have large economic stakes in South Africa. Although Britain has shown some skepticism about the utility of a Summit declaration against apartheid --which could generate more pressure for economic sanctions--we believe the British would accept the majority view. London may raise the idea of "positive sanctions"--such as aid to poor blacks in South Africa and neighboring countries--to avoid charges that it is thwarting efforts to find an agreed Summit position. [ ]

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Middle East Prime Minister Thatcher remains committed to a UN-sponsored Middle East peace conference but, for now, opposes Western overtures to Damascus aimed at facilitating such talks. Thatcher prefers to emphasize Jordan's role in a possible West Bank federation and may stress the need to encourage Jordanian economic development of the West Bank as a way of breathing new life into the Middle East peace process. [ ]

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Iran-Iraq The British claim to follow a policy of "scrupulous neutrality" in the war. Nevertheless, Thatcher will almost certainly resist any US attempt at the Summit to halt non-lethal arms sales to Iran. She will argue that British trade with Iran keeps open a channel of communication that puts the UK in a better position to apply pressure on Tehran to end the war. The British may favor a Summit statement on the need to protect Gulf shipping, given Kuwaiti concerns over missile attacks on its tankers. [ ]

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ITALYPolitical Setting

Italy will be represented at the Summit by a caretaker government headed by Senate President Amintore Fanfani following the recent collapse of former Prime Minister Craxi's center-left coalition. Although the caretaker government is composed primarily of Christian Democrats, it bills itself as non-partisan and will probably try to avoid positions that would be domestically contentious. Acting Foreign Minister and veteran politician Andreotti is likely to play a more important role at the Summit than the Prime Minister, who has only been marginally involved in policymaking in recent years. [REDACTED]

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Most Italian political leaders will be focusing their attention on the national election scheduled for 14 June. Public opinion polls suggest the Socialists and the Christian Democrats will score modest gains, while the smaller coalition partners and the Communist opposition may suffer losses. Although another center-left coalition remains the likeliest outcome of the election, the bitterness of recent competition between the Socialists and Christian Democrats for the Prime Minister's office could produce a minority coalition dependent on the Communists for its survival. [REDACTED]

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Economic Setting

Italy's economic prospects remain generally promising. Private consumption and investment continue to fuel growth, which is likely to reach 3.0 percent this year. The steady decline in the inflation rate during 1986 substantially narrowed the differential between Italy and the other Summit countries, although inflation may pick up again after mid-1987. The current account registered a surplus in 1986 and is likely to stay positive this year. The economy remains plagued, however, by a huge public sector deficit, which at 12 percent of GDP is more than double that of the other Summit countries. Rome is also concerned about persistently high unemployment, which is expected to increase somewhat above 11 percent. [REDACTED]

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Goals for the Summit

The Fanfani government's principal goal at the Summit will be to preserve and enhance Italy's hard-won status as a major player in Western political and economic decisionmaking while avoiding actions that would compromise its domestic non-partisan orientation. All Italian political leaders agree that Rome should have a role in international affairs commensurate with that of the other Summit participants, especially given the current assumption in Rome that Italy's economy rivals the British and French in size. Their concerns over the roles of the G-5 and G-7, however, were resolved with the recent decisions regarding the mandates of both groups. Fanfani and Andreotti will probably refrain from any controversial

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initiatives on high profile issues, such as the Middle East or arms control, in order to avoid criticism by the Socialists or other parties for exceeding their mandate. In any case, the Italian delegation will probably be ill-equipped to take a leading role at the Summit because the political leadership's preoccupation with domestic politics has hamstrung governmental preparation on substantive issues. [redacted]

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### Economic Issues

#### Macroeconomic Policy Coordination and International Monetary Reform

Rome will probably let other Summit countries take the lead on these issues, while generally pressing for a more stable monetary system. Rome sees the US budget deficit and global trade imbalances as potential threats to world economic stability and wants West Germany and Japan to pursue more expansionary policies. The Italians will be restrained in expressing their concerns, however, because of Rome's vulnerability to criticism about its own economic imbalances. Although Rome's views on the indicators approach to macroeconomic policy is unclear, Italy favors creation of exchange rate target zones based on a dollar-yen-ECU alignment. Rome, however, will almost certainly resist any measures that limit its own sovereignty over monetary policy and thereby threaten the financing of its huge public sector debt. [redacted]

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Structural Adjustment Italian leaders are increasingly aware of the importance of structural adjustment for economic development and sustained growth and can point to several recent initiatives in this area. These include the liberalization of capital and financial markets through the creation of new financial instruments and institutions and the loosening of exchange controls, as well as reform of the controversial wage indexation system. Rome remains supportive of OECD work in this area and will endorse continued progress toward structural reforms. [redacted]

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Agricultural Reform and Trade Italy's agricultural policy is bound to the EC's Common Agricultural Policy, and this makes it unlikely that Rome will take an independent stance on agricultural issues at the Summit. Nevertheless, as a net importer of foodstuffs, Italy clearly has an interest in any proposals that would result either in a lower food import bill or in reduced EC farm subsidies. Rome sees agriculture as a priority problem and probably will press for its consideration, but advocates flexibility and compromise. Although Rome may thus be somewhat more receptive than Paris or Bonn to US proposals for modifying the CAP, the Italians believe that the EC member states must demonstrate community solidarity and maintain a firm defense of the CAP. Rome will probably argue that the main problem is not import duties or export rebates--mechanisms that the US considers to be subsidies--but surpluses, and will note that the EC is moving to reduce surpluses. Rome may suggest the need for a multilateral agreement among the various agricultural producers to limit production of goods that are in surplus such as dairy products, grains, and beef. [redacted]

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Third World Debt Rome has traditionally been more sympathetic than other Summit countries to the plight of Third World debtors. The Italians are likely to argue that debt servicing problems force the LDCs to rely entirely on running trade surpluses and hold them hostage to increased world trade, growth, and demand. Rome generally wants to see growth in world trade, increased development aid, and changes in financing that will permit the LDCs to cope with their debt. Specifically, they could argue for more flexible debt management including provision of a transition period, multiyear debt rescheduling arrangements, debt-equity swaps, and even genuine relief measures that are not tied to tough conditionality.

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New Round and International Trade Italy's foreign trade deficit and growing protectionist sentiment in some Summit countries will put trade issues high on Italy's list at Venice. Rome will condemn protectionism and emphasize the need for GATT surveillance. On the subject of the Uruguay Round, the Italians are likely to push for resuming the prenegotiations and for creating a mechanism to monitor any agreements on protectionism developed during the round. Although the Italians will probably support the inclusion of trade in services in the GATT, they probably would ignore a generalized approach to liberalization in favor of an approach that acknowledges differences across sectors. Overall, Rome appears interested in demonstrating flexibility and reaching a compromise on sensitive trade issues, but Italy will be cool toward US positions because of several outstanding US-Italian trade disputes.

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#### Other Economic Issues

Energy Nuclear power was one of the issues that impeded the formation of a new five-party coalition. The issue is a post-Chernobyl reaction to Rome's longstanding plan to increase the share of electricity generated by nuclear power from the current 3.6 percent to nearly 12 percent by the end of the century. The Christian Democratic, Republican, and Liberal parties favor continuing the present energy plan, while the parties on the left support a gradual phasing out of nuclear power. This delicate political division will incline Italy's caretaker leaders to favor a neutral Summit statement on nuclear power. On the issue of non-nuclear energy, provisions passed into law in 1986 have restructured the Italian Strategic Oil program, but the changes have led to a higher dependence on finished product imports without changing the overall volume of stocks.

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Science and Technology Italian interest in international cooperation on technology diffusion continues through its participation in joint programs such as EUREKA, SDI, and its own world laboratory project. Moreover, the government's support for SDI research is seconded by the enthusiasm of Italian firms about SDI participation. Rome's own attempt, however, to increase the exchange of scientific information through "open laboratory" agreements has been limited. Fanfani will probably support a Japanese proposal for a "Human Frontier Science Program," while avoiding a firm commitment on funding.

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## Political Issues

East West Relations Although Italian officials have been favorably impressed by Gorbachev's reform efforts, they suspect his long-term objective is to make the Soviet system more efficient rather than more open. Nonetheless, they hope that Gorbachev's policies will lead to expanded exports to the Soviet Union that will improve Italy's negative trade balance with the Soviet Union. Rome currently has no major bilateral political differences with Moscow, leaving Fanfani free to lie low in discussions on East-West issues. Andreotti, however, may be more attentive. [redacted]

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Arms Control and Disarmament Rome has responded more positively than other Summit participants to Moscow's proposal to eliminate both long- and short-range intermediate nuclear forces. Some senior diplomatic and military officials worry, however, that the "zero option" will leave Western Europe militarily vulnerable because of Soviet advantages in conventional forces and tactical nuclear weapons. At a minimum, they want the lower limit for SRINF reduced from 500 to 300 kilometers in order to cut down what they believe would be a vast Soviet advantage in tactical nuclear weapons under the higher limit. Andreotti has also said publicly that he favors the West pursuing a "global strategy" on disarmament by taking into account Soviet nuclear forces deployed against Asia. At the strategic level, Rome strongly supports a "narrow" interpretation of the ABM Treaty and might reconsider its participation in SDI research if the US adopted the "broad" interpretation. [redacted]

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Terrorism Rome generally favors increased international cooperation on technical measures to combat terrorism and would go along with changes in the Tokyo Declaration that would introduce measures such as coordinating visa policies and controlling diplomatic baggage. It would probably also support strengthening the Bonn Declaration against airplane hijacking. At the same time, Andreotti personally favors a generally conciliatory policy toward states sponsoring terrorist groups and flexible handling of hostage situations. Rome would thus probably not endorse any statement that tied its hands in responding to terrorist incidents. [redacted]

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South Africa Italy was initially a fence straddler on the South African problem but is moving toward a tougher stand against Pretoria. It formerly opposed sanctions but now goes along with the EC majority, primarily in response to internal pressures from the Italian left. So far, the mild punitive measures imposed by the EC in 1985 have not touched areas of vital concern to Rome; Italy does, however, depend on South Africa for much of its gold, coal, and strategic mineral needs and would be concerned about any tougher actions that would threaten their availability. Rome would support a Summit declaration condemning apartheid and is exploring the possibility of increasing aid to South African non-whites. [redacted]

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Middle East Both Fanfani and Andreotti have long favored increased international involvement in efforts to resolve the Arab-Israeli conflict as well as a major role for the Palestine Liberation Organization, and they support the EC's stance favoring a UN-sponsored peace conference. Although both men have a tendency to defend Arab interests, they are unlikely to press controversial initiatives at the Summit because their positions do not enjoy universal support at home. Former Prime Minister Craxi and former Defense Minister Spadolini, for instance, have little patience with the PLO, and Spadolini generally supports the Israeli position favoring direct negotiations. Italy contributes troops to the Multinational Force in the Sinai. [REDACTED]

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Iran-Iraq Rome publicly is neutral in the Iran-Iraq war but, in practice, tilts toward Iraq while doing its best not to offend Iran. Rome recently clamped down against Italian firms supplying weapons and equipment to both sides. It now seeks a negotiated end to the fighting and would not favor a Summit statement that took too strong a tilt against Iran. [REDACTED]

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## CANADA

Political Setting

Despite its landslide electoral victory in 1984, Prime Minister Mulroney's Conservative government has plummeted to 24 percent in the polls, far behind the Liberals (42 percent) and the socialist New Democrats (32 percent).

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Elections are expected in the fall of 1988, but could be delayed until September 1989. Although it is too early to rule out a rebound in Conservative fortunes, at present we rate Mulroney's chances of retaining his parliamentary majority as no better than one out of four.

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Economic Setting

Canadian economic growth slowed to 3.1 percent in 1986 and is expected to be 2.5 percent this year. The slowdown is due to more moderate growth in private consumption, the lingering effects on exports of last year's fall in prices for energy and grain, and Ottawa's attempts to keep a tight rein on government spending. Modest growth will not lower unemployment much below last year's average rate of 9.6 percent; nor will it reduce the inflation, which is likely to remain around 4.0 percent. Moreover, despite an expected 15-percent increase in the merchandise trade surplus over the 1986 level, servicing expanded capital inflows will keep Canada's current account deficit on par with last year's record \$6.3 billion.

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Goals for the Summit

Because of his political troubles, Mulroney is particularly interested in the Summit as a venue for highlighting his stature as a leading Western statesman; he will host Commonwealth and Francophone summits later this year. Ottawa's main substantive economic objectives at the Summit are to push progress on agricultural trade liberalization and the removal of barriers to its other exports. The Canadians are likely to support US positions on most trade and monetary issues, but will push for more attention to Third World debt and LDC trade problems. On political issues, Ottawa will generally support US positions on arms control and East-West issues, and will endorse a tough stance against terrorism. On South Africa, however, Mulroney will probably go beyond US policy, and propose the creation of a high-level task force to coordinate Western policy toward the region.

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## Economic Issues

### Macroeconomic Policy Coordination and International Monetary Reform

Although economic policy coordination is not a primary issue with Canadians, and Ottawa has not yet clarified its views on the use of indicators, it recently voiced support for the need for policy coordination at the "Big Four" trade ministers meeting in Japan. On monetary reform and the use of target zones, the Canadians have remained non-committal while expressing support for exchange rate stability. Finance Minister Wilson, moreover, has publicly avoided making any commitment to undertake joint official intervention. Canadian sensitivity to the impact of domestic monetary policy on exchange rates is more focused on stabilizing trade and investment with the US. [redacted]

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Structural Adjustment The Mulroney government's record on structural adjustment has been mixed. The government plans to introduce tax reform legislation sometime this spring, probably emphasizing a broad-based value-added tax as well as revisions to personal and corporate rates that will bring Canada more in line with the new US codes. Moreover, Ottawa has introduced legislation--following the lead of several provinces--to reform and deregulate the financial services sector. Deregulation has also taken place in the oil and natural gas industries. Despite these efforts to encourage investment, Ottawa has retained discretionary powers in reviewing foreign investment in order to protect Canadian control of key industries, particularly in energy, banking, and "cultural" sectors. Ottawa has made efforts to privatize several federally-owned crown corporations, but proposals to sell the country's biggest air carrier and one of the largest integrated oil companies have raised nationalist sentiments. Furthermore, Ottawa probably believes that these efforts are beginning to produce diminishing political returns. Delays in introducing comprehensive tax reform, the shelving of a report recommending an overhaul of the unemployment insurance system, and extensive use of subsidies and investment incentives all reflect the Mulroney government's unwillingness to take potentially unpopular actions when its public standing has fallen so low. Ottawa is unlikely, therefore, to give any substantial support to statements endorsing accelerated structural reform. [redacted]

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Agriculture--Reform and Trade Agricultural trade liberalization will remain a major Canadian interest, as it was at the GATT talks in Uruguay and at last year's Summit. Ottawa, concerned by what it sees as a growing grain war between the US and the EC, will continue to press for trade reform. According to press reports, Prime Minister Mulroney intends to present a proposal at the Summit dealing with the subsidized grain trade on behalf of the Cairns Group of "non-subsidizing" grain exporters in GATT. The Canadians have proposed schemes over the past several months aimed at cutting supplies [redacted]

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[redacted] Ottawa is unlikely to

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press too hard on the need for domestic policy reforms, however, because of the improbability of quick agreement among the major grain traders

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Third World Debt Ottawa continues to support the Baker Plan. Finance Minister Wilson has stressed the need for capital infusions to developing nations trapped between high external debt burdens and weak export markets, as well as the need for these countries to make appropriate adjustments to their economic policies. He has called for an expansion of IMF borrowing limits and an IDA replenishment of at least \$12 billion. Wilson considers Brazil's decision to stop interest payments a negotiating tactic, but federal banking officials are urging federally-chartered banks to increase reserves against loans to debtor nations. Canadian banks are worried that they may have to classify their Brazilian loans as non-accrual and that a writedown on loans to other debtors may be necessary.

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New Round and International Trade While preoccupied with gaining freer access to the US market, the Canadians have also maintained a strong interest in multilateral trade negotiations and have promoted the idea that international trade can be enhanced by providing the GATT with greater monitoring and dispute settlement capabilities. In addition to their specific concerns over agricultural reform, the Canadians are pushing for liberalized trade in other commodities, such as forest products and minerals because such commodities make up a large part of Canadian exports. In this respect, Ottawa's approach to commodity trade has much in common with the attitudes of many LDCs. Therefore, Canadian efforts to obtain expanded market access provide Ottawa an opportunity to champion views that Third World development could be stifled by the expansion of trade barriers in industrialized countries.

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#### Other Economic Issues

Energy Despite its vast energy potential, Canadian reserves are expensive to develop, and Ottawa is concerned that supply shortages may occur by the 1990's. To grapple with this problem, Ottawa has initiated a series of studies and conferences to develop a national energy policy with an emphasis on security of supply. In bilateral consultations with the US, Canadian officials have noted that the policy will include provisions for emergency stocks and have expressed interest in discussing this issue at the IEA Ministerial in May.

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Nuclear Power Notwithstanding a vocal domestic anti-nuclear lobby, Ottawa would probably support a statement favoring continued development of nuclear power, but might insist that such a statement also emphasize safety and nonproliferation concerns. Canada depends on nuclear energy for 13 percent of its electricity, but in the industrial province of Ontario this figure approaches 40 percent. Another incentive for Canadian support of nuclear energy is Ottawa's hopes for further foreign sales of the CANDU reactor, developed by a government-owned corporation.

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Environment The Canadians are extremely concerned about cross-border pollution and could press for statements on the need for greater international cooperation on environmental issues. Canadians are particularly sensitive about acid rain, but Ottawa has expressed some optimism about reaching an agreement with the US to cut cross-border emissions after President Reagan's recent decision to seek the \$2.5 billion for research and demonstration projects he endorsed last year and his expressed willingness to consider an accord aimed at cutting acid rain pollution. [REDACTED]

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Science and Technology Ottawa recently increased spending for a variety of research and development programs, but the stated focus has been on developing space-related technologies. Although the Canadians are likely to applaud Japanese efforts in biological research, Ottawa would be hard pressed to fund more than token participation in any program. [REDACTED]

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### Political Issues

East-West Relations The Mulroney government generally supports US positions on East-West relations. Although Canadian officials have praised the trend toward reform in the Soviet Union, Ottawa has continued to speak forcefully on the need for drastic improvements in human rights policies in the East bloc. Ottawa continues to abide by COCOM restrictions but in an attempt to expand trade with the East recently relaxed regulations on trade in civilian products with the Warsaw Pact. Ottawa has also resumed cultural and scientific contacts with the Soviet Union that were broken off after the invasion of Afghanistan. [REDACTED]

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Arms Control and Disarmament Ottawa endorses most US arms control positions, but a vocal Canadian peace movement tempers the government's public pronouncements on this issue. Mulroney's administration endorses SDI research as prudent and allows Canadian companies to bid on SDI projects. External Affairs Minister Clark, however, has repeatedly called on the US to conduct SDI research within the limits of a strict interpretation of the ABM Treaty. Ottawa recently renewed its permission for the US to test unarmed cruise missiles in Canada but has reproached Washington for breaking-out of the SALT II limits. The Canadians fully support US positions in the START and INF negotiations but worry about the possibility of a split between the US and the European Allies over the SRINF issue. [REDACTED]

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Terrorism Ottawa strongly supports US and international efforts to combat terrorism, but is concerned that the US arms shipments to Iran have undercut US credibility on this issue. In addition to endorsing a strengthened Bonn Declaration, Mulroney almost certainly would support a tough anti-terrorism statement. Canada has proposed a new protocol to the International Civil Aviation Organization's Montreal Convention on terrorism that would expand the agreement to cover terrorist acts at

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international airports. Ottawa has placed limited economic sanctions on Libya, and Mulroney was quick to offer public support the US raid on Tripoli. Following the UK's break in relations with Syria, Ottawa recalled its ambassador from Damascus. The ambassador recently returned

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South Africa Mulroney's visceral hatred of apartheid ensures his intense interest in the South African issue, and he also knows that Canadians expect their government to be a moral leader on the international stage. Canada has played a leading role in Commonwealth action against apartheid since the early 1960s and has imposed limited economic sanctions against Pretoria. The Canadians continue to be attracted to moral grandstanding on the South African question; for example, following a trip to the Frontline States in January, Mulroney hinted that Canada might impose further sanctions or even break diplomatic relations, and External Affairs Minister Clark recently called for 30,000 Canadians to sign a petition against apartheid he will deliver to the UN.

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Canadian officials responded favorably to a US-proposed Summit statement on South Africa, but noted that Mulroney may wish to toughen the statement, according to the US Embassy in Ottawa. We believe he will probably propose that the Summit countries explore increasing their assistance to the Frontline States and to blacks in South Africa. Mulroney is also likely to propose that the Summit Seven create a high-level body--possibly at the foreign minister level--charged with continually reviewing South African developments. Ottawa apparently believes such a group would improve coordination of Summit country policies on apartheid and be available to serve as an intermediary between the contending parties in South Africa.

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Middle East Although Canada is not a major Middle East player, it participates in multinational peacekeeping forces in Lebanon, the Golan Heights, and the Sinai Desert, and supports the US efforts to encourage the peace process. Canada maintains close relations with Israel--despite a recent flap arising from Canadian refusal to accept an Israeli military attache--and has only low level contacts with the PLO. Egypt is one of the top recipients of Canadian foreign aid, and Canadian officials have stated that Jordan's "willingness to risk for peace" would be supported with some Canadian economic aid, even though Jordan does not meet Ottawa's standard criteria for need. Canadian officials have shown interest in the idea of an international peace conference--if it was acceptable to Israel--but Ottawa would probably prefer to see direct negotiations between Israel and its neighbors.

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Iran-Iraq Ottawa has remained carefully neutral in the Gulf War and would most likely support a "balanced" statement calling on both sides to negotiate an end to the conflict. Canada maintains an embassy in Baghdad, and would probably reopen its Tehran embassy--closed after the 1980 rescue

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of American diplomats--if Iran dropped its demand that Ottawa apologize for its role in that affair. Ottawa opposes the sale of arms to Iran or Iraq

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## EUROPEAN COMMUNITY

### Political Setting

The EC--30 years old this year--has become a major policy organ in Western Europe. The early passion for creating a federal Europe has been replaced by a pragmatic realization that steady though plodding progress toward economic integration and foreign policy coordination is the most that can be expected. The Community has been a back-bench participant at the annual Economic Summits since 1977. All twelve members will be represented in the EC delegation, which will contain representatives of both the Commission and the Council of Ministers. We expect that EC Commission President Jacques Delors, a former French finance minister, will speak for the EC in the areas over which it has direct competence. These include agriculture, trade, and--to a lesser extent--macroeconomic and monetary policy. He will overshadow Belgian Prime Minister Wilfried Martens, whose country holds the rotating presidency of the Council of Ministers, on economic issues. Martens, however, may speak for the Community on political issues. [REDACTED]

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### Economic Setting

The EC continues to struggle with consistently high unemployment and a failure to compete with the United States and Japan on the same technological level. The two key items on the Community's agenda--the budget and overcoming obstacles to the creation of a unitary EC internal market--illustrate how the EC as an institution can both hinder and help in finding solutions to the economic problems of the member states. The chronic budget crisis, exacerbated by a falling dollar and to a large extent the result of farm spending, consumes the EC's time and energy and divides the members along north-south lines. According to Commission estimates, a projected \$5.7-billion shortfall in the 1987 Community budget will occur by October. Delors has proposed a long-range solution, which would raise available revenues by tying national contributions to GNP, but members are unlikely to agree to this until spending is brought under control. The effort to liberalize the internal EC market has made some initial progress in improving the competitive environment. Progress has been halting, however, because members are reluctant to give up control over elements of strong national concern--such as border controls and indirect taxation--for the sake of freer trade. [REDACTED]

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### Goals for the Summit

EC representatives will probably be most interested in expanding cooperation to stabilize exchange rates and in maintaining pressure on Japan to cut its trade surplus. These issues are of particular importance to the Community because they relate directly to the stability of the European Monetary System (EMS), the EC budget, and EC trade policy. At the same time, we believe the EC representatives will want to avoid any

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language in the Summit statement committing the Community to specific action on agriculture. The EC representatives are unlikely to press for any statements on political issues. [REDACTED]

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### Economic Issues

#### Macroeconomic Policy Coordination and International Monetary Reform

The EC is likely to call for greater economic policy coordination among Summit participants and, in particular, for expansionary fiscal policies in Japan and in Europe. Delors is likely to suggest that West Germany--and, to a lesser extent, the UK and France--should take the lead in reviving growth prospects in Europe by accelerating tax cuts and tax reform measures, as well as boosting public investment. He is unlikely to push the point too hard, however, because of German resistance to playing "locomotive" for the world economy. Delors also may argue--consistent with a Commission-prepared plan to boost growth in the EC--that government infrastructure spending and private investment must be expanded throughout Europe and that labor must agree to slow the growth of real wage costs in order to make a dent in EC unemployment. [REDACTED]

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The Community's top priority in the monetary area is to prevent a further decline of the dollar. The EC's effort to liberalize member state capital markets by 1992--in which Delors takes a personal interest--requires a strong and highly stable EMS, and a further slide of the dollar would almost certainly force another realignment of EMS currency rates. Delors will continue to advocate close cooperation to stabilize exchange rates, building on recent Group of Seven agreements. He may call on the United States to do more for dollar stability by cutting its fiscal deficit and adopting a more restrictive monetary policy. [REDACTED]

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Structural Adjustment At the Summit, Delors is likely to promote the EC's intention to complete the opening of its internal market by 1992 as the central element of the Community's effort to assist the restructuring of European economies. Guaranteeing complete freedom of movement for goods, services, capital, and persons has become the Community's top economic priority since Delors took office. The Commission's plan is aimed at reducing bureaucratic interference in business decisions and giving EC firms the advantages of a more unified home market to help improve competitiveness. Although they are failing to keep up with the decisionmaking schedule because of disagreements over details, it is fully supported by the member states and has been moderately successful so far. Delors reportedly also favors a British plan within the EC to remove bureaucratic restrictions on small businesses and to make them a focus of employment creation within the Community. [REDACTED]

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Agriculture--Reform and Trade The EC will probably want to focus the Summit's work on agriculture toward a statement calling for progress on reform at the Uruguay Round of the GATT. The Community has endorsed the recent OECD call for gradual and balanced reductions in agricultural

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subsidies and is likely to support appeals to stabilize markets and end aggressive export practices. Delors may support the creation of a grain exporters' cartel, although he is aware of US antipathy to this idea. He probably will not be amenable to a statement calling for an early, separate agreement on agriculture at the GATT round. He will likely resist any attempt to single out the Common Agricultural Policy (CAP) for criticism, pointing to progress made since last year on cutting milk and beef production. [ ]

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In general, both Delors and the Commission as a whole are strong supporters of agricultural reform, although they are unable to accelerate reform proposals because of the need in practice for unanimous agreement among the member states. Pressure for reform of the CAP--which consumes \$25 billion a year, or two-thirds of EC spending--is building because of the Community's chronic budget crisis. The Commission this year has proposed a price freeze for most commodities, a price cut of almost 3 percent for grain, an expanded role for the free market in farm sales, and a radical plan allowing national direct payments to farmers whose incomes fall below a regional average. The direct income payment plan is likely eventually to facilitate agreement among the members on price cuts and acreage reductions, essential steps toward lower production, reduced export subsidies, and a smaller budgetary burden. We believe the Community will agree--but probably not until after the Summit--on a reform package, probably including price cuts and strictly monitored direct income payments, that will incrementally improve the operation of the CAP's subsidy system. [ ]

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The Commission's proposed tax on vegetable oil production--potentially affecting US soybean exports to the EC of \$2.5 billion annually--may still be under consideration by EC agriculture ministers at the time of the Summit, even though it is likely to fail eventually because of strong resistance from the UK and West Germany, both of which are concerned about the prospect of another serious trade dispute with the United States. To the extent reform measures reduce the CAP budget, however, revenue provided by the tax would be less needed. Nevertheless, the tax could be raised in bilateral discussions at the Summit. [ ]

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Third World Debt The Commission has no real competence in the area of debt, but Delors is likely to argue in favor of maintaining enlarged LDC access to IMF resources, increasing World Bank lending, and fostering macroeconomic policies aimed at expanding developed country growth as partial solutions to the problem. [ ]

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New Round and International Trade An important EC priority will be maintaining pressure on Japan to take concrete measures to cut its trade surplus with the Community. The surplus increased by over 50 percent in 1986, to \$17 billion, and the Commission fears that, because the yen has not appreciated as much against European currencies as against the dollar, Japan is refocusing its export drive on the EC. Delors will probably argue

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for greater Japanese import promotion, export restraints, and a restructuring of the Japanese economy toward domestic-led growth. He may also stress that Japan has benefited greatly from the international trading system and should take more responsibility for adjustment, specifically by reducing its huge trade surplus. The EC is currently challenging Japan on a large number of trade issues: dumping of computer printers, dumping of components for so-called "screwdriver" plants, dumping of semiconductor chips, and the US-Japan semiconductor agreement. [ ]

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Delors would be likely to support a Summit statement calling for early agreement--around mid-1988--on issues under consideration at the Uruguay Round, but only if it does not single out agriculture for "fast track" treatment. The Commission is firmly committed to strengthening the multilateral trading system and has said that it intends to play a major role in making the round a success. [ ]

25X1

Delors may also voice Commission concerns about the threat of protectionism in the United States. The Commission has threatened retaliation should legislation in the US Congress to restrict textile imports into the United States come into effect. [ ]

25X1

#### Political Issues

East-West Relations The EC Council of Ministers' meeting in April adopted a cautious, "wait-and-see" attitude toward Gorbachev's domestic reform program. EC members, nevertheless, are somewhat optimistic about reduced East-West tensions so long as Gorbachev remains in power. EC talks with CEMA on the establishment of relations are stalled over the EC's insistence that CEMA recognize West Berlin as EC territory, though a compromise is likely to be worked out this year. The EC has made some progress toward bilateral trade accords with Romania, Czechoslovakia, and Hungary. [ ]

25X1

Arms Control and Disarmament Last month in an interview in France, Delors proposed holding an EC summit to discuss General Secretary Gorbachev's arms control proposals, even though as President of the Commission he has no direct competence on the issue. Neither he nor Martens is likely to pursue this idea at the Venice Summit so as not to get ahead of other EC members on the issue. [ ]

25X1

South Africa Most EC members oppose further economic sanctions against Pretoria, but Martens may endorse a Summit statement condemning apartheid. This would be consistent with a planned EC statement, which may be issued in late May. The Community also hopes to foster closer ties with the Frontline States in southern Africa, and would endorse a statement to that effect. Budgetary constraints, however, preclude large-scale aid. [ ]

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Middle East Martens is likely to encourage support--especially from the United States--for a UN-sponsored Middle East peace conference. Since February, EC officials have been promoting the idea through diplomatic contacts with likely participants. [REDACTED]

25X1

Iran-Iraq Officially neutral, the Community believes an European initiative would be unable to resolve the Iran-Iraq War. It does support efforts undertaken by UN Secretary-General Perez de Cuellar to mediate. EC partners remain concerned about an escalation in the war which could lead to the disruption of Western Europe's vitally needed oil imports. [REDACTED]

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